

## REQUEST LETTER

06-024

June 16, 2006

TP REPRESENTATIVE

Re: Ruling Request

Dear TP REPRESENTATIVE:

On behalf of our client CORPORATION, we respectfully request a written ruling and clarify on your State's taxation of DSL technology and the applicability of the Internet Tax Freedom Act (discussed below) to such technology. The relevant facts regarding this request are outlined below.

### **FACTS**

CORPORATION provides voice and data communications products and services to consumers and businesses at both the wholesale and retail end-user level. CORPORATION provides these services throughout the United States in approximately 235 major metropolitan areas in 35 states. CORPORATION is a regulated entity holding a CPCN or other regulatory license issued by the state Commission charged with the responsibility of regulating the telecommunications industry.

CORPORATION'S services include high-speed, or broadband, data communications, Internet access connectivity, Voice over Internet Protocol telephony, or VoIP, and a variety of related services. CORPORATION primarily uses digital subscriber line ("DSL"), and DS-1, also referred to as T-1, technologies to deliver their services.

CORPORATION'S DSL network utilizes existing 2-wire copper telephone wiring, DSL routing equipment, high speed transmission circuits, and Internet encapsulation and routing protocols to provide its end users with a high speed connection to the Internet. By using these technologies, CORPORATION transmits a signal at 30 KHz to 100 KHz. Since simple voice is transmitted at .3 KHz to 3.5 KHz, the two signals can occupy the same physical wire.

Internet routing equipment, such as Digital Subscriber Line Access Multiplexers and DSL access routers/bridges (commonly referred to as DSL modems) located at the end-user's location translate the signal and create a seamless connection to the Internet. CORPORATION purchases access to telecommunication lines and central office facilities from the traditional local telephone companies, which are often referred to as the incumbent local telephone companies, or ILECs, and then combines these network elements with their own nationwide network facilities to provide its DSL service.

CORPORATION provides DSL services in two general forms. The first is referred to DSI+IP or Broadband Internet Access (“BIA”). This service is a Layer 3 data service that provides a DSL connection to the Internet at CORPORATION’S “Point of Presence” or POP. The DSL circuit actually connects to CORPORATION’S POP. Layer 3 service allows the end user to connect directly to the internet. The additional IP services include end-user authentication, authorization and accounting, IP address assignment and management, domain name service and IP routing and connectivity.

The second general category of service is DSL connectivity that CORPORATION provides to one of its wholesale partners. These partners are telecommunications carriers, ISP’s or other resellers. These resellers utilize CORPORATION’S DSL and T-1 connections and add their own Internet access services.

### **LEGISLATIVE OVERVIEW**

On December 3, 2004, President George W. Bush signed the Internet Tax Nondiscrimination Act, S. 150, 108<sup>th</sup> Cong §§1-8 (2004) (enacted) (“ITNA”). This legislation extended the moratorium on taxes on Internet access services originally outlined in the Internet Tax Freedom Act and made several significant changes to the federal statute.

Most notably, the legislation expanded the definition of exempt Internet access by including telecommunications services that are purchased, used, or sold to provide Internet access. A plain reading of this legislation clarifies that State and local governments are prohibited from imposing taxes upon telecommunications services purchased, used, or sold by a provider of Internet access to provide access to the Internet.

ITNA was enacted in order to prevent States from taxing the foundation (the underlying telecommunications services) of Internet access service. In addition, the legislation prevents States from taxing Internet access on an inconsistent basis due to the various methods ISPs employ to assemble and provide Internet access services. In other words, ITNA was crafted in order to prevent a competitive advantage among ISPs by applying the same level of taxation for all services necessary to provide access to the Internet.

ITNA preempts State and local taxation of telecommunications services “purchased, used, or sold by a provider of Internet access to provide Internet access.” This legislation was purposely drafted using the same language States frequently use to impose tax on specific goods and services. Accordingly the same consideration must be given to this Federal exemption as the States give legislation which imposes a sales or use tax on goods and services.

Based on the foregoing information, we respectfully request the following:

- 1) With respect to The Internet Tax Nondiscrimination Act, S. 150, 108<sup>th</sup> Cong §§1-8 (2004) enacted), please confirm your State will not impose a

telecommunications based transaction tax, such as a sales, use, excise, utility or gross receipts tax on the DSL services CORPORATION provides to its customers. In addition, please provide an explanation of the tax treatment, including all statutory support if you do not support the conclusion that is requested.

- 2) With respect to the Internet Tax Nondiscrimination Act, S. 150, 108<sup>th</sup> Cong. (2004) (enacted), please confirm your State will not impose a telecommunications based transaction tax, such as a sales, use, excise, utility or gross receipts tax on the sale of Layer 2 communications services to a non-Internet service provider who owns and operates their own point of presence (“pop”) equipment. In addition, please provide an explanation of the tax treatment, including all statutory support if you do not support the conclusion that is requested.
- 3) With respect to the Internet Tax Nondiscrimination Act, S. 150, 108<sup>th</sup> Cong. §§1-8 (2004) (enacted), please confirm your State will not impose a telecommunications based transaction tax, such as a sales, use, excise, utility or gross receipts tax on the services CORPORATION purchases in order to provide DSL services. In addition, please provide an explanation of the tax treatment, including all statutory support if you do not support the conclusion that is requested.

Thank you in advance for your assistance with this request. Please contact 2<sup>ND</sup> NAME or the undersigned at ###.###.#### if you have any questions or require additional information.

Sincerely,

NAME  
ADDRESS  
PHONE  
FAX

## **RESPONSE LETTER**

October 12, 2007

NAME  
ADDRESS

Re: Private Letter Ruling 06-024

Application of Sales Tax Provisions to taxation of DSL technology and the applicability of the Internet Tax Freedom Act to such technology.

Dear NAME,

This letter is in response to your request for tax guidance. This letter ruling is not intended as a statement of broad Tax Commission policy. It is an interpretation and application of the tax law as it relates to the facts presented in your request letter and the assumptions stated in the Analysis portion of this ruling letter. If the facts or assumptions are not correctly described in this letter ruling, please let me know so we can assure a more accurate response to your circumstances.

**Facts**

CORPORATION, provides voice and data communications products and services to consumers and businesses at both the wholesale and retail end-user level. CORPORATION currently provides these products in some 35 states and requests information regarding transaction-based taxes, such as a sales, use, excise, utility or gross receipts tax on its services provided in Utah.

CORPORATION'S services include high-speed, or broadband, data communications, Internet access connectivity, Voice over Internet Protocol telephony, ("VoIP"), and a variety of related services. CORPORATION primarily uses digital subscriber line ("DSL"), and DS-1, also referred to as T-1, technologies to deliver their services.

CORPORATION'S DSL network is created in a way that existing paired copper wires simultaneously carry both voice and data communications. DSL modems located at the end-user's location translate the signal and create a connection to the Internet. CORPORATION purchases access to telecommunication lines and central office facilities from the traditional local telephone companies, which are often referred to as the incumbent local telephone companies, ("ILECs"), and then combines these network elements with their own nationwide network facilities to provide its DSL service.

CORPORATION provides DSL services in two general forms. The first is referred to DSL+IP or Broadband Internet Access ("BIA"). You have described this as a Layer 3 data service. The Tax Commission's understanding is that that this is a reference to the Network Layer of the 7-Layer Open Systems Interconnection model. This BIA service provides a DSL connection to the Internet at CORPORATION'S "Point of Presence" or POP. The DSL circuit actually connects to CORPORATION'S POP. Layer 3 service allows the end user to connect directly to the internet. The additional IP services include end-user authentication, authorization and accounting, IP address assignment and management, domain name service and IP routing and connectivity.

The second general category of service is DSL connectivity that CORPORATION provides to one of its wholesale partners. These partners are telecommunications

carriers, ISP's or other resellers. These resellers utilize CORPORATION'S DSL and T-1 connections and add their own Internet access services.

### **Relevant Authority**

#### **Internet Tax Freedom Act and Amendments**

Effective October 1, 1998, the Internet Tax Freedom Act, Public Law No. 105-277, (the "Act") placed a moratorium on any state or local tax on Internet access. At its inception, the act defined Internet access as:

a service that enables users to access content, information, electronic mail, or other services offered over the Internet and may also include access to proprietary content, information, and other services as part of a package of services offered to consumers. Such term does not include telecommunications services.

Effective December 3, 2004, The Internet Tax Nondiscrimination Act, Public Law 108-435, extended the moratorium on tax on Internet access as provided in the Act and previous amendments. The 2004 legislation also extended the protection of the Act to include certain telecommunications services. The 2004 amendments replaced the phrase "[s]uch term does not include telecommunications service" in as used in the act with:

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"Internet access" does not include telecommunications services, except to the extent such services are purchased, used, or sold by a provider of Internet access to provide Internet access.

The Internet Tax Nondiscrimination Act also clarified taxation of VoIP services:

Nothing in this Act shall be construed to affect the imposition of a tax on a charge for voice or similar service or similar service utilizing Internet Protocol or any successor protocol. This section shall not apply to any services that are incidental to Internet access, such as voice-capable e-mail or instant messaging.

Internet Tax Nondiscrimination Act, § 1108, 49 U.S.C. § 609.

#### **State Sales and Use Tax**

Utah Code Ann. §59-12-103(1)(b) provides for sales or use tax on "amounts paid" to a "telephone service provider" for "telephone service . . . that originates and terminates within the boundaries of this state."

“Telephone service,” as used in Utah Code Ann. §59-12-103(1)(b), is defined in Utah Code Ann. §59-12-102 (100) in a way that excludes from taxation any service for which the Internet Tax Freedom Act does not allow taxation:

"Telephone service" means a two-way transmission:

- (i) by:
  - (A) wire;
  - (B) radio;
  - (C) lightwave; or
  - (D) other electromagnetic means; and
- (ii) of one or more of the following:
  - (A) a sign;
  - (B) a signal;
  - (C) writing;
  - (D) an image;
  - (E) sound;
  - (F) a message;
  - (G) data; or
  - (H) other information of any nature.
- (b) "Telephone service" includes:
  - (i) mobile telecommunications service;
  - (ii) private communications service; or

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(iii) automated digital telephone answering service.

(c) "Telephone service" does not include a service or a transaction that a state or a political subdivision of a state is prohibited from taxing as of July 1, 2001, under the Internet Tax Freedom Act, Pub. L. No. 105-277.

### **Municipal Taxes**

In addition to state sales and use tax, municipalities have the authority to levy taxes on telecommunications. Utah Code Ann. §10-1-403 provides for a license tax on a “telecommunications provider's gross receipts from telecommunications service that are attributed to the municipality.”

Utah Code Ann. §10-1-410 provides that services that are not telecommunication services that are provided are subject to municipal tax when provided in connection with telecommunications services unless the nontelecommunication services are either separately identified in the provider’s statements or services for which federal law prohibits taxation:

- (1) For purposes of this section, "nontelecommunications services" means services or tangible personal property that are:
- (a) not telecommunications service; and
  - (b) provided by a telecommunications provider to a customer.
- (2) Except to the extent prohibited by federal law, if a telecommunications provider provides nontelecommunications services to a customer as part of the same transaction in which the telecommunications provider provides telecommunications service, the gross receipts from the nontelecommunications services provided by the telecommunications provider are subject to a tax under this part unless:
- (a) the charge for the nontelecommunications services is separately identified in the statement of the transaction with the customer of the telecommunications service; or
  - (b) from the books and records of the telecommunications provider that are kept in the regular course of business, the telecommunications provider can reasonably identify the portion of the total charge for the transaction that is attributable to:
    - (i) the nontelecommunications services; and
    - (ii) the telecommunications service.

### **Funding for Emergency Telephone Services**

Utah Code Ann. §26-2-5 provides for a charge to pay for local 911 emergency telephone services. Utah Code Ann. §26-2-5.6 provides for a fee for statewide 911 emergency services. Utah Code Ann. §26-2-5.5 provides for a surcharge on each line of service to pay for poison control.

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“telephone service” from Utah Code Ann. §59-12-102 (100), and thus specifically does not include as part of taxable telephone service those services for which the Internet Tax Freedom Act does not allow taxation. Sections 26-2-5.5 and 26-2-5.6 do not specifically define telephone service.

Generally, VoIP services do not come under state requirements to provide 911 or Enhanced 911 (“E911”) service because the Federal Communications Commission has ordered VoIP providers to provide emergency telephone service such as E911. *See In the Matter of Vonage Holdings Corporation*, WC Docket No. 03-211, Order FCC 04-267 (2004). Because there has been a federal preemption of the regulation of E911 service by VoIP carriers, state law will not generally apply to those areas preempted by the federal government. But since the Federal Communications Commission requires VoIP carriers to provide E911 service, VoIP carriers will generally voluntarily pay state and municipal E911 fees to be allowed to connect to the existing e911 system. *See In the Matter of E911 Requirements for IP-Enabled Service Providers*, WC Docket No. 05-196, Order FCC 05-116 (2005).

### **Analysis and Ruling**

For each of the taxes at issue, Utah law provides for taxation to the extent not prohibited by the Internet Tax Freedom Act, Public Law No. 105-277, as amended by the Internet Tax Nondiscrimination Act, Public Law No. 108-435. For sales and use tax, the applicable Utah statutes specifically mention the Internet Tax Freedom Act. The Utah statutes governing municipal taxes provide for taxation only “to the extent [not] prohibited by federal law.” Because the Internet Tax Freedom act and the Internet Tax Nondiscrimination Act that amends it are both federal law, Utah will not tax to the extent prohibited by these acts. With regard to the fees for emergency telephone service, for which the statutes at issue do not specifically look to federal law, the Tax Commission finds that there has been a federal preemption that prevents taxation of services covered by the Internet Tax Freedom Act, as amended.

Having concluded that Utah law allows taxation only to the extent allowed by the Internet Tax Freedom Act (the “Act”), as amended, the Commission considers CORPORATION’S services in light of the Act and its amendments. Originally, the Act generally provided for a moratorium on taxes on Internet access. Although the Act did not allow taxes in Internet access, it made an exception for “telecommunication services,” which the act excluded from the definition of “Internet access service.”

In 2004, the Internet Tax Nondiscrimination Act amended the definition of Internet Access Service in the Act. The original exception to the taxation ban for “telecommunications services” was narrowed to “telecommunications services, except to the extent such services are purchased, used, or sold by a provider of Internet access to provide Internet access.” The Internet Tax Nondiscrimination Act also specifically excludes Internet voice services from the tax moratorium by providing that nothing in the Internet Tax Nondiscrimination Act “shall be construed to affect the imposition of tax on a charge for voice or similar service utilizing Internet Protocol or any successor protocol.” Mindful of this language in the amended Act, the Tax Commission will respond to each of the three specific questions CORPORATION raises regarding taxation.

1. *With respect to The Internet Tax Nondiscrimination Act, S. 150, 108<sup>th</sup> Cong. §§1-8 (2004) enacted), please confirm your State will not impose a telecommunications based transaction tax, such as a sales, use, excise, utility or gross receipts tax on the DSL services CORPORATION provides to its customers. In addition, please provide an explanation of the tax treatment, including all statutory support if you do not support the conclusion that is requested.*

Applying the Act to CORPORATION’S services sold to ultimate consumers, it is apparent that some of its services are telecommunications services intended to carry voice rather than to provide Internet access. Even though VoIP service is carried over an Internet connection, its purpose is to carry voice communication. The Act, as amended, specifically preserves taxation for VoIP services. Thus, VoIP services are subject to taxation notwithstanding the moratorium on taxation of other services. See Internet Tax Nondiscrimination Act, § 1108, 49 U.S.C. § 609.



That portion of CORPORATION'S DSL service providing internet connectivity is covered by the Act and is thus not subject to taxation so long as CORPORATION is a provider of Internet access and the DSL services are meant to provide Internet access. To qualify for sales of Internet connectivity without taxation, CORPORATION would need to be able to identify these Internet services separately from voice service or other taxable services.

2. *With respect to the Internet Tax Nondiscrimination Act, S. 150, 108<sup>th</sup> Cong. (2004) (enacted), please confirm your State will not impose a telecommunications based transaction tax, such as a sales, use, excise, utility or gross receipts tax on the sale of Layer 2 communications services to a non-Internet service provider who owns and operates their own point of presence ("pop") equipment. In addition, please provide an explanation of the tax treatment, including all statutory support if you do not support the conclusion that is requested.*

The Tax Commission understands the reference to Layer 2 communications in this request to refer to the Data Link Layer of the 7-Layer Open Systems Interconnection model and that this Layer provides Point-to-Point Protocol ("PPP"), High-Level Data Link Control ("HDLC") and Advanced Data Communication Control Protocol ("ADCCP") for point-to-point connections. Although services such as these can be used to link computers without providing Internet access, the Commission understands your request to include this service only when used to gain Internet access. As such, this Layer 2 service "enables users to access content, information, electronic mail, or other services offered over the Internet" as described in the Act and is thus not subject to taxation under Utah law because Utah adopts the provisions of the Act.

Your specific question refers to Layer 2 communication service that would be sold to others for resale to other end users. If this were case, the sale from CORPORATION to the reseller would not be taxable, because Utah Code Ann. §59-12-104(32) exempts from taxation sales to authorized resellers. Under these circumstances, CORPORATION would ask the resellers for their Utah sales tax license numbers to satisfy itself that it was dealing with an authorized reseller.

If CORPORATION were to provide Layer 2 communications to end users for reasons other than Internet access, this would be a communications network and would be taxable as telecommunications service. Utah and its municipalities cannot, however, levy a tax for E911 service because the Federal Communications Commission has ruled in this area. The Utah Tax Commission has generally allowed VoIP carriers operating in Utah to voluntarily pay E911 fees to connect to the traditional E911 system.

3. *With respect to the Internet Tax Nondiscrimination Act, S. 150, 108<sup>th</sup> Cong. §§1-8 (2004) (enacted), please confirm your State will not impose a telecommunications based transaction tax, such as a sales, use, excise, utility or gross receipts tax on the services CORPORATION purchases in order to provide DSL services. In addition, please provide an explanation of the tax treatment,*

*including all statutory support if you do not support the conclusion that is requested.*

Telephone services purchased for resale are not subject to taxation. Utah Code Ann. §59-12-104(32). Thus, if CORPORATION purchases telephone service capability that it later resells, the original purchase is not taxable. To purchase communication services for resale, CORPORATION would need to obtain a Utah sales tax license.

CORPORATION would pay sales or use tax for otherwise taxable goods or services for which it is the end user. Office supplies and office telephone service would be examples of taxable goods and services if CORPORATION consumed these items rather than reselling them.

### **Conclusion**

VoIP service is generally taxable when sold in Utah. Telephone service purchased for resale is generally not taxable until resold, provided the purchaser for resale takes the necessary steps in accordance with Utah law. Services to provide Internet connectivity are generally not subject to taxation under the provisions of Utah law because Utah law dovetails with the Internet Tax Freedom Act and its amendments.

The Tax Commission provides this opinion on the basis of the information provided it. No person should rely on this opinion for facts other than those you provided in your initial letter and those supplemental facts as described in this letter. If you wish to address these or other Utah tax concerns further, please do not hesitate to contact us.

For the Commission,

Marc B. Johnson  
Commissioner

MBJ/CDJ  
06-024